

Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

17 October 2025

Dear Mr Barckow,

Re: Request for Information – Post-implementation Review IFRS 16 Leases

On behalf of the EFRAG, I am writing to comment on the Request for Information on the Post-implementation Review of IFRS 16 *Leases*, issued by the IASB on 17 June 2025 ('the RFI').

Overall assessment (Question 1). EFRAG considers that IFRS 16 *Leases* ('IFRS 16') is generally working well and has largely met its objective of improving lease-related financial reporting. Stakeholders appreciated the increased transparency and comparability resulting from the requirement for lessees to recognise most leases on the balance sheet. However, ongoing costs for preparers remain high, particularly in lease-intensive sectors, driven by the need to maintain lease data and IT systems and to manage lease modifications.

Despite IFRS 16 generally working well and largely meeting its objective, EFRAG's constituents have raised multiple issues that arise especially when deviating from standard-form lease agreements. Some of these issues should be addressed by the IASB in a timely manner.

IFRS 16 Issues. Consistent with stakeholder's expectations that only targeted improvements should occur, EFRAG considers the following issues as a high priority that should be addressed by the IASB. Issues are split into conceptual issues, application issues and interactions with other accounting standards.

Conceptual issues

- *Statement of cash flows* (Question 3). Stakeholders expressed several specific concerns regarding the presentation and disclosure of cash flow information related to leases. Some respondents highlighted difficulties with connecting, or reconciling, the statement of cash

flows to the statement of profit or loss and to the statement of financial position and with comparing entities with leases to entities that borrow funds for the purchase of assets. EFRAG considers that the IASB should discuss and improve the presentation of leases in the statement of cash flow as part of its Statement of Cash Flows and Related Matters project.

Application issues

Scoping of IFRS 16:

- *Distinction between lease and in-substance purchase of asset* (Question 6.4). Stakeholders raised significant concerns on the complexity of distinguishing between a lease and an in-substance purchase due to lack of clear guidance. This causes diversity in practice as transactions that are in-substance purchases of assets may be accounted for differently (either as leases or as purchases of assets), affecting comparability in the financial statements and key performance indicators. There is a strong call from EFRAG's constituents for the IASB to provide additional guidance on the definition of a lease to distinguish between these transactions.
- *Identifying lease transactions* (Question 6.4). The identification of a lease is consistently cited as one of the main application issues encountered by preparers. Stakeholders noted that determining whether a contract falls within the scope of IFRS 16 can be complex, particularly in relation to certain intangible assets such as software licences and cloud computing services.

Interactions with other accounting standards

- *Interaction between IFRS 16 and IFRS 9 Financial Instruments ('IFRS 9')* (Question 6.1). There is a lack of clarity in distinguishing between lease modifications under IFRS 16 and lease liability extinguishments under IFRS 9 in case of a lessor's forgiveness of future lease payments. This has led to diversity in practice, with lessees applying either IFRS 9 (recognising a gain) or IFRS 16 (adjusting the right-of-use asset). EFRAG disagreed with the recent amendments to IFRS 9 as they do not resolve the conflict. Therefore, EFRAG recommends a narrow-scope project to clarify the distinction between lease modifications and extinguishments and specifying which standard prevails when it is unclear.
- *Interaction between IFRS 16 and IFRS 15 Revenue from Contracts with Customers ('IFRS 15')* (Question 6.2). EFRAG received feedback highlighting challenges in assessing whether a sale has occurred in sale and leaseback transactions under IFRS 16 due to limited guidance. EFRAG considers these challenges prevalent across industries, potentially impacting the comparability and usefulness of financial information. Therefore, EFRAG

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recommends that the IASB provide clarifying guidance or illustrative examples to promote the consistent treatment of sale and leaseback transactions.

In addition, users highlighted that disclosures are partly insufficient and called for meaningful disclosures, especially in areas involving significant judgment – such as lease term, discount rate and variable lease payments. While the disclosure objective included in paragraph 51 of IFRS 16 is well articulated and requires the respective information the disclosures published in financial statements sometimes prevent users from properly assessing the effect that leases have on the financial position, financial performance and cash flows of the lessee (see Question 2).

EFRAG's detailed comments and responses to the questions in the RFI are set out in Appendix 1. Additional issues raised by EFRAG's constituents but not directly related to the questions raised in the RFI are discussed in Appendix 2.

If you would like to discuss our comments further, please do not hesitate to contact Kathrin Schoene, Juan Jose Gomez, Aleksandra Sivash or me.

Yours sincerely,



Wolf Klinz

Chair of EFRAG FRB

Appendix 1 – EFRAG’s responses to the questions raised in the RFI

Question 1 – Overall assessment of IFRS 16

IASB RFI Question 1 – Overall assessment of IFRS 16

- (a) In your view, is IFRS 16 meeting its objective and are its core principles clear? If not, please explain why not.
- (b) In your view, are the overall improvements to the quality and comparability of financial information about leases largely as the IASB expected? If your view is that the overall improvements are significantly lower than expected, please explain why.
- (c) In your view, are the overall ongoing costs of applying the requirements and auditing and enforcing their application largely as the IASB expected? If your view is that the overall ongoing costs are significantly higher than expected, please explain why, how you would propose the IASB reduce these costs and how your proposals would affect the benefits of IFRS 16.9.

EFRAG’s response

Question 1 (a) – Overall suitability of IFRS 16

- 1 Based on extensive outreach to a wide range of European stakeholders, EFRAG considers that IFRS 16 is generally working well and has broadly achieved its objective of ensuring that lessees and lessors provide relevant information in a manner that faithfully represents leases.
- 2 The notable changes introduced by IFRS 16 for lessees, especially the requirement to recognise most leases on the balance sheet, were viewed by EFRAG’s constituents as positive changes, increasing transparency, comparability and reliability of financial information by providing a more faithful representation of lease transactions. Preparers also highlighted significant implementation costs and efforts. In contrast, the lessor accounting model has remained unchanged under IFRS 16 and has consequently received less attention by stakeholders.
- 3 Despite IFRS 16 generally working well and largely meeting its objective, EFRAG’s constituents have raised multiple issues that happen especially when deviating from standard-form lease agreements. EFRAG is of the view that some of these issues should be addressed by the IASB in a timely manner (see EFRAG’s responses to questions 3, 6.1, 6.2 and 6.4).

- 4 Other aspects of the Standard related to lessee accounting, such as the determination of the discount rate, the lease term and the consideration of the variable payments, remain difficult to implement in practice and require the use of judgement. This can lead to application challenges and potential inconsistencies in practice, although such outcomes are, to some extent, inevitable in a principle-based standard. Users called for meaningful and sufficient disclosures to improve their understanding of lease arrangements and the application of management judgment. However, for other stakeholders such as preparers and auditors practice has mainly settled, and there is generally limited appetite for major changes (see EFRAG's response to questions 2).
- 5 Additional issues raised by EFRAG's constituents are included in Appendix 2 to inform and enable the IASB's analysis of these issues, along with feedback received from other respondents.

Question 1 b) – Overall improvements to the quality and comparability of information

- 6 EFRAG has collected feedback indicating that IFRS 16 has led to notable improvements in the quality and comparability of lease-related financial information, although some limitations and challenges remain.
- 7 IFRS 16 has resulted in:
- (a) more faithful representation of lease transactions. By requiring most leases to be recognised on the balance sheet, IFRS 16 has led to a more accurate reflection of financial obligations. Moreover, lessee information under IFRS 16 provides greater transparency and visibility into lease liabilities and right-of-use (RoU) assets, which were previously not recognised on the balance sheet but disclosed under IAS 17;
 - (b) more useful information for decision-making. IFRS 16 has improved the usefulness of financial information for decision-making, as it allows better assessments of cash flows, profitability and financial position. While some users noted that they still use pre-IFRS 16 figures for their analyses, many reported that the Standard has reduced the need for manual adjustments; and
 - (c) improved comparability. By applying a uniform lessee and lessor model across entities, IFRS 16 has increased the comparability of information, especially in lease-intensive industries such as retail, telecommunications and aviation. Users also appreciated the improved ability to compare leasing versus purchasing of assets. Despite some remaining differences with US Generally Accepted Accounting

Principles (US GAAP), IFRS 16 has generally helped reducing the comparability gap between IFRS Accounting Standards and US GAAP.

- 8 Preparers noted some improvements in internal controls and quality of information. For example, benefits included the enhanced ability to monitor the performance of lease transactions, better understanding of the lease contracts portfolio and improved transparency and data quality on leases. Further, increased transparency and comparability and clearer view of leverage and risk may have had positive effects on the cost of capital in capital markets. However, some preparers, auditors and national standard setters noted that the high level of judgement required in some areas of the Standard, such as determining the lease term and discount rate, may lead to diversity in practice, potentially impairing comparability.

Question 1(c) – Ongoing costs

- 9 Preparers incur significant ongoing costs, particularly for purchases of IT solutions, staff training, recurring consulting and audit costs – especially in industries with large and complex lease portfolios (e.g. retail, automotive).
- 10 These ongoing costs are primarily driven by the need to continuously update lease data, maintain IT systems and assess complex lease modifications. Stakeholders acknowledged that over time practice has settled and the recurring application of IFRS 16 has become embedded in internal systems. However, in some cases ongoing costs may exceed initial expectations, especially in cases where lease contracts are frequently modified or involve a high degree of judgement.
- 11 EFRAG notes that stakeholders generally have limited appetite for significant or disruptive changes to the existing requirements. Nevertheless, some preparers suggested that targeted improvements, such as simplifying the accounting for lease modifications, clarifying guidance on variable payments and revisiting the low-value asset exemption, could help reduce complexity and costs without compromising the benefits stemming from the Standard. Similarly, users observed that settled practice should not prevent the potential improvements, especially with regard to the comparability and understandability of information, expected from the Post-Implementation Review (PIR) process.
- 12 Based on the feedback that EFRAG received from auditors, although the technical requirements of IFRS 16 are now broadly understood in practice, auditing still requires significant resources, especially in cases involving frequent lease contract modifications, complex arrangements (e.g. subleases, embedded leases) or high levels of judgement (e.g.

when determining the lease term, assessing substitution rights or evaluating whether the contract is or contains a lease).

Question 2 – Usefulness of information resulting from lessees' application of judgement

IASB RFI Question 2 – Usefulness of information resulting from lessees' application of judgement

- (a) Do you agree that the usefulness of financial information resulting from lessees' application of judgement is *largely* as the IASB expected? If your view is that lessees' application of judgement has a *significant* negative effect on the usefulness of financial information, please explain why.
- (b) Do you agree that the requirements in IFRS 16 provide a clear and sufficient basis for entities to make appropriate judgements and that the requirements can be applied consistently? If not, please explain why not.
- (c) If your view is that the IASB should improve the usefulness of financial information resulting from lessees' application of judgement, please explain:
 - (i) *what amendments you propose the IASB make to the requirements (and how the benefits of the solution would outweigh the costs); or*
 - (ii) *what additional information about lessees' application of judgement you propose the IASB require entities to disclose (and how the benefits would outweigh the costs).*

EFRAG's response

- 13 Feedback from users reveals that IFRS 16 has improved the usefulness of financial information for decision-making, as it allows better assessments of cash flows, profitability and financial position (see response to question 1(b) above). However, EFRAG has also received the feedback that the below areas require the application of judgment, which may lead to diversity in practice.

Lease term

- 14 EFRAG notes that the determination of a lease term is generally straightforward for standard-form lease contracts, and despite some level of judgment inherent in determining the lease term, it is generally reasonable and does not lead to significant inconsistencies or undermine the comparability and usefulness of financial statements. However, stakeholders encounter challenges when lease contracts are more complex, with a higher

level of judgement involved when applying the current requirements, leading to diversity in practice.

- 15 For example, determining the non-cancellable period where extension options or tacit annual renewal options exist is particularly challenging, and the outcome will be based on management's judgement. Other examples provided by the stakeholders include 'evergreen contracts' or contracts with indefinite lives, where the non-cancellable period might be as short as a termination notice period (e.g. three or six months), as well as contracts with multiple options exercisable over time where the identification of events and circumstances triggering the reassessment of the lease term is complex..
- 16 Furthermore, some stakeholders highlighted the risk of structuring opportunities to influence a company's leverage, liquidity and solvency ratios and overall financial flexibility. Lease contracts with similar economic substance can be negotiated with different contractual terms based on the desired outcome. For example, entering into a contract with an indefinite lease term or into a lease contract with a definite lease term with or without renewal option would not be reflected in the same way in the financial statements, despite the fact that the underlying asset may be expected to be used in practice for the same period of time.
- 17 In both scenarios, whether reflecting different lease terms due to involved judgement and complexity or due to the structuring of lease contracts, EFRAG notes significant diversity in practice leading to comparability issues, even within the same industry, impacting entities' financial performance and key performance indicators (KPIs). Challenges related to lease term determination are particularly prevalent in industries such as retail, telecommunications, aviation and real estate.
- 18 Based on the feedback received from users of financial statements, despite the overall improvement of relevance and comparability brought about by IFRS 16, there are still significant comparability difficulties in contrast to the previous Standard. These issues can lead to the use of adjusted alternative performance measures to neutralise impacts resulting from the implementation of IFRS 16. A key factor contributing to this, among others, is the determination of the lease term.
- 19 Additional concerns raised by stakeholders related to the accounting for leases with non-consecutive lease periods. When it comes to the lessee having the right to use an identified asset for some non-consecutive shorter periods within a longer contract period, stakeholders noted a lack of clarity on the determination of the lease term, the depreciation period of the RoU asset and the period over which the interest expenses on

lease liability should be recognised. Applying the longer contract period rather than the accumulated period of non-consecutive use may not faithfully represent the period for which the lessee has the right to use the leased asset.

Discount rates

- 20 EFRAG agrees with the preliminary feedback obtained by the IASB and notes that determining the discount rate is identified as one of the main judgmental areas for preparers. Current requirements for determining an interest rate inherent in the lease are often perceived as overly theoretical, designed to satisfy conceptual considerations. Many entities default to determining the Incremental Borrowing Rate (IBR), which is also impacted by significant judgment being involved, leading to the application of substantially different discount rates across entities.
- 21 EFRAG's stakeholders observed that entities have developed their own accounting policies and methods to determine IBRs, which sometimes rely on highly generalised assumptions rather than entity-specific parameters, further affecting comparability. A particular concern is that, because the IBR is linked to each entity's credit risk (also with the focus on a single-entity level rather than a group level), the same contract could have different impacts on the financial performance simply due to different discount rates, thus reducing comparability. On the other hand, EFRAG observes that such diversity reflects different levels of creditworthiness assigned by financial institutions to each entity, thereby increasing comparability between leased and financed assets at the individual entity level.
- 22 Preparers noted that obtaining data necessary to estimate the IBR is costly and complex. Some of them suggested applying parent entity's marginal rate of indebtedness. Some suggested developing an overarching concept of the discount rate across the Standards and / or specifying that the rate implicit in the contract is equivalent to the IBR. EFRAG recognises that the level of costs for the approach and the observable practical outcome for the discount rate currently do not necessarily correlate. It might be difficult to find a solution, as EFRAG observed that there is no consensus as to the potential alternatives and simplifications. Users generally welcomed the improvements derived from IFRS 16 but pointed out that comparability issues persist due to differences in discount rate determination. Valuation specialists called for a more transparent and consistent application of IFRS 16 disclosure requirements to the discount rate. Some of them still preferred using pre-IFRS 16 figures without integrating IFRS 16's impact into their analyses, partly due to missing information about the discount rate, along with issues such as distorted cash flows and leverage ratios.

Variable lease payments

- 23 EFRAG's stakeholders noted that the European leasing market is increasingly evolving towards service-based contracts, where the variable payments element is becoming more significant. A number of application challenges exist related to the variable payments element – for example, in situations where variable lease payments are becoming fixed or fixed in-substance and then revert back to variable payments throughout the life of the contract. As such some stakeholders, including academics, expressed that the relevance of the information provided by IFRS 16 could be enhanced if additional types of variable considerations are evaluated when determining the lease liability. The retail industry is within the most impacted by the increased prevalence of variable payments where some preparers noted that the majority of their leases are thus off-balance sheet, questioning the relevance of information included in the financial statements by applying IFRS 16.
- 24 On the other hand, combining fixed and variable payments, may distort income statement due to the depreciation of the right-of-use asset throughout the entire lease period, even when lease payments are solely (or largely) variable over a certain part of the lease term. An example of such distortion in the income statement would be contracts with only variable lease payments at the beginning of the term (for example, in year 1 and 2 of the agreement) that become fixed payments later during the lease term, or vice versa (for example, in years 3–6). In this situation, the RoU and lease liability are computed by using the fixed payments from year 3 to year 6. However, the amortisation charge of the RoU is spread across all years (years 1–6), creating a double expense in years 1 and 2 (amortisation and variable payments). Stakeholders noted that this accounting treatment was contrary to the intended economics of such lease agreements, which are to provide some relief to the lessee during the first years of the lease – for example variable payments based on the revenue. Similarly, if the lease payments for year N are fixed based on the lessee's revenues in the preceding year, recognising a lease liability for the next annual payment (which becomes fixed only for that year) together with an equivalent increase in the right-of-use asset may create a mismatch. This occurs because the right-of-use asset is amortised over the remaining lease term, while the amortisation expense increases each year as new amounts are added to the asset's carrying amount.
- 25 In general, it can be noted that there is a difference in the accounting treatment of variable payments across standards and that there are differences in accounting between IFRS 16 and, for example, IFRS 9 or IFRS 15, where expected cash flows and variable considerations are considered as long as they are reliably estimated. A similar observation was made regarding differences between leases and leaseback transactions including variable

payments, which are considered part of the lease liability (see EFRAG's Discussion Paper [Accounting for Variable Consideration - From a purchaser's perspective](#)).

- 26 Some equity analysts deemed a different accounting treatment acceptable for leases with variable payments or short-term contracts, as these types of leases are seen to reflect a different, often lower, level of risk. However, they would like to be informed about the major contractually agreed variable obligations.

General comments

- 27 The feedback collected highlights the diversity in practice and negative impact on comparability resulting from the lessee's application of judgement, specifically related to the determination of the lease term, discount rate and requirements related to variable payments.
- 28 In the feedback provided to EFRAG, the stakeholders suggested the following improvements or solutions, which may be further considered by the IASB to mitigate the negative impacts of the use of judgement.
- (a) Regarding enhanced guidance and examples, stakeholders suggested that the IASB provide more illustrative examples and additional application guidance to support the lessee's assessment of the lease term, discount rate and variable payments.
 - (b) Some feedback suggested excluding contracts with a tacit renewal option or indefinite life from the scope of IFRS 16, as current diversity in practice leads to information being incomparable and irrelevant.
 - (c) Clarification on how past practice and entities' expectations should or should not influence the determination of the lease term would be useful, particularly when extension options do not formally exist, but rather when extensions commonly occur through contract modifications.
 - (d) Additional guidance specific to the short-term lease exemption could be used to avoid structuring opportunities on one hand and to better align with the normal business cycle on another (for example, extending short-term exemption to leases going beyond 12 months if a company's business cycle is longer – i.e. machinery leased for a specific construction work taking more than 12 months but still being limited in time and being considered within the business cycle of the company).
 - (e) Regarding the distinction between variable and in-substance fixed payments, some stakeholders noted that the current interpretation of 'unavoidable payments' might limit the identification of in-substance fixed payments to very few circumstances.

- (f) The accounting for variable lease payments could be linked to an index when the updated index is not promptly available but has to be applied retrospectively. There is a lack of clarity on how to account for such adjustments to previous payments.
 - (g) When there is more than one realistic set of payments, IFRS 16 requires entities to consider the lowest amount, which some stakeholders believed may not reflect the economic substance of the contract, as the lease liability is determined at the lowest amount rather than the more probable one. A suggestion was made to reconsider this requirement, including the probability criterion;
 - (h) Regarding the overarching concept of discount rate, there was a call for the IASB to develop an overarching concept of discount rate across IFRS Accounting Standards where possible for standardisation purposes and to reduce effort on the part of preparers.
- 29 Users highlighted the lack of sufficient disclosures of the areas subject to judgement. Specifically, users pointed out that the objectives in paragraph 51 of IFRS 16 are not always achieved in practice, and as a result, users do not obtain the information they need to ‘assess the effect that leases have on the financial position, financial performance and cash flows of the lessee’. As such, users noted that even if in principle IFRS 16 provides the corresponding disclosure requirements, there are a number of areas where the disclosures should be improved, for example:
- (a) the lease term, such as disclosing the basis for expectations, key assumptions, average lease terms;
 - (b) potential impacts arising from renewal options rather than including renewal options for the measurement of the lease liability;
 - (c) the expected time of use of the underlying asset or similar asset as if it would have been purchased (i.e. as opposed to leased);
 - (d) disclosures about the assumptions and methodology used when determining the IBR;
 - (e) additional qualitative and quantitative disclosures of variable lease payments, including key variability drivers and expense classification, and how they are presented in the financial statements, including information about variable lease payments not included in the measurement of a lease liability (i.e. forward-looking information based on management’s estimate).

Question 3 – Usefulness of information about lessees' lease-related cash flows

IASB RFI Question 3 – Usefulness of information about lessees' lease-related cash flows

Do you agree that the improvements to the quality and comparability of financial information about lease-related cash flows that lessees present and disclose are largely as the IASB expected? If your view is that the improvements are significantly lower than expected, please explain why.

EFRAG's response

- 30 EFRAG received feedback suggesting that IFRS 16 improved the quality and comparability of information provided about lease transactions. However, stakeholders expressed several specific concerns regarding the presentation and disclosure of cash flow information. These issues have been identified during EFRAG's outreach activities and in the context of EFRAG's [Discussion Paper](#) ('DP') on the statement of cash flows. Some respondents (including some users) commented that they have difficulty connecting or reconciling the statement of cash flows to the other primary financial statements (specifically the statement of profit or loss and the statement of financial position) in relation to leases. As such, many preparers and users rely on adjusted cash flows / non-GAAP cash flows provided in the financial statements or prepared by users when they can. These adjustments include changing the classification of the items within the cash flow statement. For example, 12 of the 40 groups included in the CAC 40, the main index on the Paris Stock Exchange, published alternative cash flow measures in 2023, according to a survey carried out by the Autorité des Marchés Financiers. Cash flow analysis and projections are important for investment decisions and for credit rating decisions. EFRAG considers that these issues, which can be grouped into the areas below, are of high priority.
- (a) **Classification of lease-related cash flows.** Stakeholders, notably preparers, questioned whether splitting lease payments across operating (e.g. variable lease payments and short-term lease payments) and financing categories (e.g. repayment of lease liability), as well as the breakdown of lease payments between principal and interest components, faithfully represent lease transactions.
- (b) **Comparability between leasing versus purchasing of an asset.** Stakeholders, notably users, expressed a preference for lease transactions to be reflected in the statement of cash flows in a comparable manner to asset purchases financed by debt, with capital expenditure classified within the investing category and debt repayments in the financing category. This would be an improvement in that it would lead to a more comparable presentation of the two transactions in the statement of

cash flows, as they are considered economically similar. Also, in some lease transactions involving the entity (lessee), the manufacturer or supplier, and a financing party (lessor), the transaction is not a lease but a loan from the financing party to finance the acquisition of the underlying asset (see Question 6.4(a) *Distinction between lease and in-substance purchase of asset*). Some argue that these transactions should be reflected in the statement of cash flows as an investing cash outflow for the acquisition of the asset and a financing cash inflow for the origination of a bank loan at inception, with subsequent payments being reported as financing cash outflows for the repayment of the bank.

- (c) **Disclosures.** Users noted the insufficient disclosures related to cash flows and expressed the need for improved disclosures (e.g. clearer identification of capital and interest cash flows). On the other hand, the disclosure of future cash outflows from extension options and termination options was criticised as complex and costly by preparers, providing an inconclusive total figure. It was suggested that the disclosure requirement for future cash outflows should focus on exposure arising from extension options and termination options within a certain timeframe – for example, the next 12 months.

- 31 EFRAG acknowledges the diverse feedback provided by constituents and encourages the IASB to take it into consideration as part of its Statement of Cash Flows and Related Matters project to improve the presentation and disclosure of leases.

Question 4 – Perspectives on ongoing costs for lessees of applying the measurement requirements

IASB RFI Question 4 – Perspectives on ongoing costs for lessees of applying the measurement requirements

- (a) Do you agree that the ongoing costs of applying the measurement requirements in IFRS 16 are largely as the IASB expected? If your view is that the ongoing costs are significantly higher than expected, please explain why, considering how any entity-specific facts and circumstances (such as IT solutions) add to these costs.
- (b) If your view is that the ongoing costs are significantly higher than expected, please explain how you propose the IASB reduce these costs without a significant negative effect on the usefulness of financial information about leases.

EFRAG's response

- 32 Overall, EFRAG's stakeholders expressed mixed views on the cost-benefit balance of IFRS 16, with a majority claiming that benefits outweigh costs while acknowledging that ongoing costs remain significant. Certain industries with large and complex lease portfolios reported that they perceive the costs as disproportionate to the benefits. Similar feedback was noted for the companies where the percentage of lease assets relative to total assets is small; however, efforts to comply with IFRS 16 are significant.
- 33 The main areas of significant ongoing costs are highlighted in our response to question 1(c) above. Feedback provided by EFRAG's constituents in relation to ongoing costs of applying the measurement requirements is outlined below.
- 34 Regarding determining the discount rate:
- (a) obtaining the incremental borrowing rate is very costly, especially for different durations and countries, often requiring payment to external providers;
 - (b) its subjective nature and the need to reflect entity-specific parameters, rather than highly generalised assumptions, contribute to complexity and cost;
 - (c) volatility from periodic updates to the discount rate creates difficulties in explanation, both internally and externally.
- 35 Regarding contract modifications and index-linked payments:
- (a) remeasuring lease liabilities due to contractual changes is very complicated, burdensome and costly, particularly in industries like retail where modifications can occur monthly. This often necessitates implementing specific IT system;
 - (b) when remeasuring all lease liabilities each time, changing an index (e.g. Consumer Price Index) is a complex and costly exercise, especially for multinational companies;
 - (c) lack of clarity on how to account for retrospective adjustments when updated indexes become available late adds to complexity and cost;
 - (d) some disclosure requirements, particularly those for expenses related to variable lease payments, short-term leases and low-value assets, can be costly due to the high manual workload and lack of IT system integration; and
 - (e) managing a large number of immaterial lease contracts leads to significant costs, despite their limited financial statement impact.
- 36 There are higher than expected IT costs (IT solutions and necessary interfaces) mainly associated with some requirements that are particularly complex to model in an IT solution

(such as the differentiated treatment of increases and decreases in the scope of a lease and changes in discount rates triggered by a change in the lease term).

- 37 With respect to disclosure requirements, data collection for the disclosure requirement in IFRS 16.59(b) (future cash outflows from variability, extension/termination options) is complex, time-consuming and costly.
- 38 Some respondents did not provide feedback on the cost assessment as such; however, they suggested measures that could improve the provisions of the Standard designed to decrease the costs.
- (a) With regard to the low-value asset exemption, it was noted that the low-value asset exemption, being linked to a fixed monetary value, becomes less relevant over time. Stakeholders noted that the threshold has to be linked to the overall materiality assessment, as a fixed monetary threshold is questionable from the perspective of a principles-based standard. Further, it was suggested that the low-value asset exemption should also apply to sublease transactions.
- (b) Some stakeholders noted that the practical application of the portfolio application appears to have been limited, often due to objections regarding how to reflect one-off events.
- (c) With regard to the costs associated with the disclosures required by paragraph 59(b), some stakeholders suggested replacing the requirements of paragraph 59(b) on the variability of future cash outflows with more granular qualitative and quantitative information on actual cash flows, allowing users to better understand how an entity uses leases with variable payments, extension options and termination options in its operations.

Question 5 – Potential improvements to future transition requirements

IASB RFI Question 5 – Potential improvements to future transition requirements

Based on your experience with the transition to IFRS 16, would you recommend the IASB does anything differently when developing transition requirements in future standard-setting projects? If so, please explain how your idea would ensure:

- (a) users have enough information to allow them to understand the effect of any new requirements on entities' financial performance, financial position and cash flows;
and

- (b) preparers can appropriately reduce their transition costs when implementing new requirements for the first time.

EFRAG's response

- 39 EFRAG's constituents welcomed the options provided under the transition requirements (e.g. modified retrospective approach) and some simplifications (e.g. in determining discount rates), which helped them in reducing workload and complexity that would be otherwise needed under the full retrospective initial application. Indeed, the majority of the respondents to our outreach activities applied the modified retrospective method, including practical expedients, mainly because it was less costly and complex to apply. Some preparers, who applied the full retrospective approach, indicated that this was to have more comparable information among different periods.
- 40 Almost none of the users responding to our outreach activities identified issues in terms of the usefulness of the information provided by the entities when initially applying IFRS 16 despite the two transition methods being allowed. However, it was also noted that entities with significant lease contracts should be encouraged to use the full retrospective approach.
- 41 Overall, EFRAG considers that through the two allowed methods and practical expedients, the IFRS 16 transition requirements achieved an appropriate balance between minimising transition costs for preparers of financial statements and providing useful information to users of financial statements. Going forward, we expect that in future standard-setting activities the IASB will continue to evaluate on a case-by-case basis any exemptions from the full retrospective approach.
- 42 EFRAG also notes that the exemption from discounting where the effect is not material may be of limited effect as entities need to calculate the discounting effect to determine if it is immaterial. Therefore, EFRAG recommends that the IASB avoid introducing cost-relief measures when exercising such relief would itself require entities to incur the cost that the measure is intended to eliminate.

Question 6 – Other matters relevant to the assessment of the effects of IFRS 16

Question 6.1 – Applying IFRS 16 with IFRS 9 to rent concessions

IASB RFI Question 6.1 – Applying IFRS 16 with IFRS 9 to rent concessions

- (a) How often have you observed the type of rent concession described in Spotlight 6.1?

- (b) Have you observed diversity in how lessees account for rent concessions that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?
- (c) If your view is that the IASB should act to improve the clarity of the requirements, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

EFRAG's response

Question 6.1(a)(b) – Prevalence and accounting diversity of rent concessions

- 43 EFRAG has received feedback from preparers, large accounting firms and national standard setters about the lack of clarity on the distinction between lease modifications in the scope of IFRS 16 and lease liability extinguishments in the scope of IFRS 9 in case of a lessor's forgiveness of future lease payments.
- 44 The lack of clarity and potential diversity in practice arises because a lessee may account for the rent concession either by:
- (a) applying paragraphs 3.3.1 and 3.3.3 of IFRS 9 to the extinguished part of the lease liability recognising in profit or loss the effect of the forgiveness of lease payments; or
 - (b) accounting for the forgiveness of lease payments by applying the lease modification requirements in paragraph 46(b) of IFRS 16 recognising the effect of the forgiveness of lease payments as a decrease in the carrying amount of the right-of-use asset. This situation is also illustrated in Illustrative Example 19 of IFRS 16.
- 45 EFRAG has received feedback from its constituents whereby stand-alone rent concessions are especially frequent during periods of severe economic difficulty, such as the COVID-19 pandemic, and occur across industries.
- 46 EFRAG notes that, as a result of an IFRS Interpretation Committee's (IFRS IC) initial recommendation to clarify whether a lessee applies IFRS 9 or IFRS 16 in accounting for a rent concession (i.e. a rent concession where the lessor legally releases the lessee from its obligation to make specifically identified lease payments), the IASB amended IFRS 9 in July 2024 through the Annual Improvements Volume 11. The Amendments clarified that when a lessee has determined that a lease liability has been extinguished by applying IFRS 9, the lessee is required to recognise any resulting gain or loss in profit or loss in accordance with paragraph 3.3.3 of IFRS 9 (i.e. before the Amendments to paragraph 2.1(b)(ii) of IFRS 9 did not make reference to paragraph 3.3.3).

- 47 EFRAG disagreed in its final comment letter with the proposed Amendment in response to the Exposure Draft IASB/AI/ED/2023/1 *Annual Improvements-Volume 11*. In EFRAG's view, the Amendments did not resolve the conflict between IFRS 9 and IFRS 16 because a change in a lease arrangement that results in a lease liability being extinguished in accordance with IFRS 9 meets the definition of a lease modification in Appendix A of IFRS 16.
- 48 In addition, some considered that the Amendments make the conflict more evident, as many had interpreted paragraph 2.1(b)(ii) of IFRS 9 as currently worded to leave out intentionally (rather than by an oversight) any reference to paragraph 3.3.3 of IFRS 9. In their view, paragraph 3.3.1 of IFRS 9 was helpful in providing guidance as to when part of a lease liability is extinguished before the lease modification requirements of IFRS 16 are applied.
- 49 BC2.45 of IFRS 9 also states that the IASB concluded that clarifying that interaction between IFRS 9 and IFRS 16 is beyond the scope of an annual improvement.
- 50 Based on the feedback received, EFRAG considers this to be an important matter which becomes critical and specifically prevalent in situations of economic difficulty –situations that give rise to specific information needs for which comparable information is key. Thus, EFRAG considers this a priority issue that should be addressed in a timely manner.

Question 6.1(c) – EFRAG's recommendation

- 51 EFRAG recommends that the IASB clarify the interaction between IFRS 9 and IFRS 16 as part of a narrow-scope standard-setting project. Such a project could clarify how a lessee distinguishes between a lease modification as defined in IFRS 16 and an extinguishment of a lease liability in accordance with IFRS 9. Moreover, in cases where there is not a clear distinction, the IASB could clarify which standard takes precedence.

Question 6.2 – Applying IFRS 16 with IFRS 15 when assessing whether the transfer of an asset in a sale and leaseback transaction is a sale

IASB RFI Question 6.2 – Applying IFRS 16 with IFRS 15 when assessing whether the transfer of an asset in a sale and leaseback transaction is a sale

- (a) How often have you observed difficulties in assessing whether the transfer of an asset in a sale and leaseback transaction is a sale?
- (b) Have you observed diversity in seller-lessees' assessments of the transfer of control that has had, or that you expect to have, a material effect on the amounts reported, thereby reducing the usefulness of information?

- (c) If your view is that the IASB should act to help seller-lessees determine whether the transfer of an asset is a sale, please describe your proposed solution and explain how the benefits of the solution would outweigh the costs.

EFRAG's response

Question 6.2(a)(b) – Prevalence and accounting diversity of sale and leaseback transactions

Application issues related to the assessment of whether the transfer of an asset in a sale and leaseback transaction is a sale

- 52 EFRAG has received feedback from entities, auditors and national standard setters about application challenges in assessing whether the initial transfer of the underlying asset in a sale and leaseback transaction from the seller-lessee to the buyer-lessor is a sale. EFRAG also received similar feedback in the context of the post-implementation review of IFRS 15, which was reported to the IASB.
- 53 There is a lack of specific or additional guidance within IFRS 16 on how to make this assessment. For determining when a performance obligation is satisfied (i.e. when the control of an asset is transferred to the customer and therefore the sale is made), reporting entities tend to apply IFRS 15 (paragraphs 31–34 and 38). The following challenges were reported by constituents.
- (a) IFRS 16 does not address whether a lessee's renewal options permitting the seller-lessee to extend the lease for substantially all of the remaining economic life of the underlying asset precludes sale accounting.
- (b) There could be circumstances where determining the unit of account is challenging (e.g. a sale of a four-floor building with one floor being leased back).
- 54 Accounting literature developed by large audit firms suggests some possible approaches to accounting for the above application issues.
- (a) In the case of the application issue referred to in paragraph 53(a), in some cases a renewal option may be similar in economic substance to a purchase option, which may preclude the sale – for example, if a leaseback contains a fixed-price renewal option that the seller-lessee is reasonably certain to exercise and which would extend the lease term to cover substantially all of the economic life of an underlying asset.
- (b) In relation to paragraph 53(b) above, an acceptable approach according to a large audit firm could be to consider a separate sale or a sale and leaseback transaction

for each floor only if each floor meets the definition of lease component in paragraphs B32 and B33 of IFRS 16.

55 However, IFRS 16 does not provide specific guidance to account for the above-mentioned application issues. Thus, the IASB's stakeholders may develop different approaches to account for them, which may result in similar transactions being accounted for differently and reducing the usefulness of the information received by users.

56 EFRAG has received feedback whereby the issues highlighted in paragraph 53 above are prevalent issues affecting all industries and which the IASB should give high priority in finding a solution. Therefore, based on the feedback received, EFRAG considers this to be a high priority issue.

Other sale and leaseback application issues

57 EFRAG has also received feedback whereby occasionally there are transactions where it is unclear whether an entity should apply the specific sale and leaseback provisions. In practice, this complexity often arises in three-party arrangements involving the entity (lessee), the manufacturer (supplier) and the financing party (lessor). The entity agrees that the financing party purchases the asset directly from the manufacturer and, in turn, leases it to the entity. When this agreement is in place before the physical delivery of the asset from the manufacturer to the entity, it can be challenging to determine whether the entity obtains control of the asset prior to the financing party's purchase. Factors such as whether the asset is bespoke or custom-made and whether the entity has made instalment payments during construction are typically considered in assessing whether the entity has obtained control. This assessment is critical in determining whether the transaction should be accounted for as a sale and leaseback, as a regular lease under IFRS 16 or even as an in-substance purchase of an asset (see question 6.4).

58 Moreover, in capital-intensive industries such as shipping, lease refinancing transactions can give rise to complexity and impact comparability. For example, when a lessee refinances a lease with a new financing party (lessor) by exercising a purchase option and immediately enters into a new lease with similar terms, the transaction may be treated as a sale and leaseback solely because the lessee is deemed to have held the asset momentarily. If the new lease also includes a purchase option (even if out-of-the-money), this often results in a 'failed sale' under IFRS 15, requiring the transaction to be accounted for under IFRS 9, according to paragraph B66 of IFRS 15. This outcome is not intuitive and leads to economically identical lease arrangements being accounted for differently (i.e. some under IFRS 16 and others under IFRS 9).

Question 6.2(c) – EFRAG’s recommendation

- 59 EFRAG recommends that the IASB explore standard-setting activity (e.g. to develop clarifying guidance and/or illustrative examples) to help address the sale and leaseback transaction application challenges identified in paragraph 53 above and reduce diversity in practice.

Question 6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

IASB RFI Question 6.3 – Applying IFRS 16 with IFRS 15 to gain or loss recognition in a sale and leaseback transaction

- (a) Do you agree that restricting the amount of gain (or loss) an entity recognises in a sale and leaseback transaction results in useful information?
- (b) What new evidence or arguments have you identified since the IASB issued IFRS 16 that would indicate that the costs of applying the partial gain or loss recognition requirements, and the usefulness of the resulting information, differ significantly from those expected?
- (c) If your view is that the IASB should improve the cost-benefit balance of applying the partial gain or loss recognition requirements, please describe your proposed solution.

EFRAG’s response

- 60 EFRAG is not aware of new information whereby the cost-benefit balance of the partial gain or loss recognition requirements is significantly different from what is expected. The limited feedback received relates to the perceived complexity of the current requirements, particularly the need to determine the gain or loss related solely to the rights transferred to the buyer-lessor. This is in contrast with the US GAAP approach where entities typically recognise the full gain or loss on disposal, which is seen by some as simpler to apply. Beyond this observation, no further issues were noted. EFRAG does not classify any changes to this aspect of the Standard as a priority.

Question 6.4 – Other matters relevant to the assessment of the effects of IFRS 16

IASB RFI Question 6.4 – Other matters

Are there any further matters the IASB should examine as part of the post-implementation review of IFRS 16? If so, please explain why, considering the objective of a post-implementation review as set out on page 5.

EFRAG's response

61 In this section, we have addressed the matters that EFRAG considers of high priority that were not included in the RFI (specifically in relation to the scoping of IFRS 16 on the distinction between lease and in-substance purchase of asset and identifying lease transactions specifically in relation to software arrangements). In the Appendix 2, we include other matters that have been brought to EFRAG's attention, including the interaction between IFRS 16 and IFRS 10 (corporate wrapper), which is considered a broader issue beyond the PIR of IFRS 16.

(a) Distinction between lease and in-substance purchase of asset

62 Feedback received by EFRAG regarding the distinction between a lease and an in-substance purchase of an asset under IFRS 16 highlights it as a complex and significant area of concern for users and preparers alike.

63 The IASB deliberately chose not to include guidance on how to distinguish between a lease and an in-substance purchase of an asset when drafting IFRS 16. They noted that the accounting for leases that are similar to the sale or purchase of the underlying asset would be similar to that for sales and purchases applying the respective requirements of IFRS 15 and IAS 16 (BC 138–140).

64 However, stakeholders noted that this lack of clarity leads to complexity and diversity in practice. This issue typically arises in three-party arrangements involving the entity (lessee), the manufacturer or supplier and a financing party (lessor). In such cases, the entity agrees that the financing party will acquire an asset, built or supplied according to the entity's specifications, directly from the manufacturer and then lease it to the entity, with the commitment to lease the same asset for the whole of its useful life and/or with a purchase option. Although the arrangement is formally structured as a lease, in many cases the financing party does not obtain control of the asset and therefore cannot transfer control to the lessee. Consequently, these transactions are, in substance, purchases of assets rather than leases. Such transactions highlight the need for the IASB to provide additional guidance on the definition of a lease to prevent entities from inappropriately accounting for purchases of assets as leases.

65 Other frequent scenarios where this issue arises are:

- (a) when a lease contract's term covers substantially the entire useful life of the underlying asset;

- (b) when a purchase option exists at the end of a lease contract regardless of whether the option is at fair market value or a lower value;
- (c) in the context of Power Purchase Agreements (PPAs), where it is challenging to determine if the arrangement is a lease or an in-substance purchase.

66 This distinction can significantly impact the overall presentation of transactions and disclosures. It may also impact the classification of payments in the statement of cash flows (investing versus financing) and measurement. While IFRS 16 addresses the impact of variable payments on the initial cost if a contract is analysed as a lease, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* do not specify how to measure the cost of an asset acquired through a contract that includes variable payments (see EFRAG's Discussion Paper [Accounting for Variable Consideration – From a purchaser's perspective](#)). Users further highlighted that this issue affects key performance indicators such as return on operating capital employed.

67 Given the lack of guidance, economically similar transactions such as those included in paragraphs 64 and 65 could be accounted for either as leases or as in-substance purchases of assets impacting comparability and key performance indicators. To avoid diversity in practice, there is a strong call for the IASB to provide additional guidance on the definition of a lease to prevent entities from inappropriately accounting for purchases of assets as leases. This issue is considered a high priority.

(b) Identifying lease transactions

68 The overall identification of a lease is consistently cited as one of the main application issues that preparers face. Stakeholders noted that the current requirements involve a high level of judgment and are complex, leading to diversity in practice among entities. To this can be added the information asymmetry existing between lessee and lessor, specifically:

- (a) assessing whether the lessee directs the use of the asset, including the transfer of control guidance in IFRS 15 to distinguish between principal or agent (i.e. principal versus agent consideration);
- (b) assessing whether the lessee has the right to control the use of an identified asset, including receiving 'substantially all economic benefits' arising from its use. IFRS 16 does not define 'substantially all', which may lead to diversity in practice, and additional complexity was identified in situations where the customer is involved in the design phase;

- (c) assessing whether the lessor has substantive substitution rights. This might be complex for contracts related to the provisions of on-premises hardware servers. Additional complexity was identified by lessees due to a lack of insight into the supplier's business model.

69 Furthermore, preparers noted many difficulties in making a distinction between leases and service contracts when the latter might include embedded leases. The issue is particularly relevant in multi-component contracts and subcontracting agreements. For example, in the automotive industry contracts entered with battery suppliers where the suppliers ensure the production on demand using very specific production machineries based on the customer specifications might include embedded leases. However, in some cases the customer does not have all the information about the supplier's production capacity to determine whether such a contract conveys the right to control the use of the underlying asset(s).

70 With regard to software arrangements, the application issues related to lease-type arrangements involving intangible assets, such as software licenses, are becoming more common, especially in high-tech industries and in relation to the energy transition. Paragraphs 3(e) and 4 of IFRS 16 create a distinction between certain intangible assets, making it challenging to determine whether IFRS 16 should be applied. This distinction lacks clear guidance, leading to challenges and to diversity in practice. We have received feedback on diversity in practice regarding how software arrangements (e.g. cloud services) are accounted for and, more specifically, regarding whether they fall within the definition of a lease. EFRAG considers that the IASB's provision of more guidance on the identification of lease transactions is of high priority.

Appendix 2 – Other issues

71 EFRAG received feedback on many other application issues, which are explained below.

(a) IFRS 10 – Sale and leaseback of a single-asset entity through corporate wrapper

72 EFRAG's constituents raised application challenges on the interaction between IFRS 16 and IFRS 10 when a sale and leaseback transaction involves the disposal of a single asset through a corporate wrapper. Stakeholders have expressed concern regarding the fact that current guidance does not provide sufficient clarity on how the requirements in IFRS 10 (concerning derecognition and recognition of gain or loss) interact with the IFRS 16 requirements on sale and leaseback transactions, potentially leading to inconsistent accounting outcomes in practice.

73 This issue is well known and was a subject in the IFRS IC tentative agenda decision, where the IFRS IC decided not to finalise the decision and instead recommended that the IASB consider narrow-scope standard setting to address the matter. The topic has already led to enforcement decisions, such as the decision published by ESMA where the issuer disposed of a wholly owned subsidiary holding a single building and leased the building back. The issuer applied the general lease principles instead of the sale and leaseback requirements in IFRS 16. The accounting was accepted given the ongoing consideration of the IFRS IC's submission.

74 Despite the issue being known, the IASB decided not to include the interaction between IFRS 10 and IFRS 16 in the context of sale and leaseback transactions involving a single-asset entity in this RFI. The IASB considered that the issue is not fundamentally a leasing matter. Rather, it is part of a broader set of challenges related to the accounting of corporate wrappers to be considered as part of a wider discussion and not within the scope of the PIR on IFRS 16.

75 EFRAG considers that this is a broader topic which has previously been considered by the IASB in the context of the post-implementation reviews of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*, as well as the post-implementation review of IFRS 15, and that it is expected to be considered in the next Agenda Consultation.

(b) IAS 36 – Application of the impairment test requirements

76 EFRAG has received feedback that the interaction between IFRS 16 and IAS 36 *Impairment of Assets* gives rise to practical challenges in applying impairment requirements, which may lead to diversity in practice. Specifically, stakeholders noted the following difficulties.

- (a) There is uncertainty on whether lease liabilities should be excluded when right-of-use assets are included in the carrying amount of a CGU.
- (b) There are challenges in separating fixed and variable lease components when forecasting cash flows for impairment testing.
- (c) There are differences in discount rate concepts between IFRS 16 and IAS 36, with discount rates under IAS 36 generally not being adjusted in practice to reflect the impact of IFRS 16.

77 There is a call for considering the provision of additional guidance to promote consistency in the application of IAS 36 in the context of right-of-use assets.

(c) Contract modifications

78 Stakeholders reported that it is difficult to assess whether a contract change should be treated as a modification to the current lease or as a separate lease, particularly when a modification includes both increase and decrease of scope. Preparers noted complexity and the cost of performing an analysis on a contract-by-contract basis where modifications are frequent and apply to large portfolios of contracts. Smaller entities find it easier to use the remeasurement requirements rather than the modification requirements (many systems cannot handle well partial remeasurement and/or require manual adjustments).

(d) Measurement of non-monetary considerations that are part of a lease payment

79 IFRS 16 is silent on how to measure non-monetary consideration when it forms part of a lease payment. This absence of clear requirements means that there is no prescribed method for valuing these types of payments, leading to application challenges and diversity in practice.

80 Stakeholders noted practical issues regarding whether non-monetary consideration should be measured at fair value (as suggested by IFRS 15) or at a discounted value (similar to how cash consideration is treated under IFRS 16). Some examples provided by the stakeholders include:

- (a) the shipping industry, where the transfer of CO₂ allowances from the lessee to the lessor for emissions is a non-cash consideration that requires measurement; and
- (b) situations where a lessee constructs a building on leased land and the building is transferred to the lessor upon completion, serving as part of the lease payment without direct monetary exchange.

(e) Diversity in practice on the practical expedient to account for the non-lease component and the lease component together

- 81 There are divergent views on how to use the practical expedient in paragraph 15 of IFRS 16 that enables an entity to not separate the non-lease component from the lease component of a contract and instead account for both together as a single lease component.
- 82 While paragraph 15 of IFRS 16 does not specify that the non-lease component must be a service, BC135 seems to imply that the non-lease component should be a service. The following is the interpretation of a large audit firm: ‘Although it is not explicitly stated, we believe that non-lease components relate to services contained within the lease contract. Paragraphs BC133 and BC135 of the Basis for Conclusions to IFRS 16 refer to non-lease components being service components. Therefore, when a lease includes a component related to the purchase of inventory or another asset such as property, plant and equipment or an intangible asset, we believe an entity should separate asset purchases from the lease components and other non-lease components.’ Other large audit firms do not specify in their IFRS accounting manuals that the non-lease component must be a service.
- 83 In addition, paragraph 15 of IFRS 16 does not specify that the practical expedient should only be applied for small amounts. However, BC135(b) specifies that the IASB expects that lessees are likely to adopt this practical expedient only when the non-lease components of a contract are relatively small.

(f) Interaction with IAS 16 on ‘initial direct costs’ and other expenditures before the leased asset becomes operational

- 84 Stakeholders observed that the definition of initial direct costs in IFRS 16 is not consistent with costs directly attributable to an asset as defined in IAS 16 *Property, Plant and Equipment*. This disparity exists even when dealing with the same underlying asset. For example, while IAS 16 clearly states that costs for transporting equipment to a job site should be capitalised, IFRS 16 offers no such guidance, leading to questions regarding the capitalisation of expenses like transportation, setting up and testing.
- 85 The issue concerning the accounting for expenditures incurred before the leased assets became operational, other than ‘initial direct costs’, primarily arises from a lack of specific guidance within IFRS 16 and the inconsistencies with IAS 16 noted above.
- 86 To address these issues, a consistent suggestion from stakeholders is to align the guidance and requirements in IFRS 16 with those included in IAS 16. A large audit firm already considers in its IFRS Interpretation Guidance that lessees may apply IAS 16 by analogy to

determine if such initial direct costs can be capitalised. This alignment would provide much needed clarity in accounting for costs incurred to bring the underlying leased asset into its working condition.

(g) Subleases

87 Overall, stakeholders reported that the requirements for subleases are only briefly addressed in IFRS 16, leading to interpretation challenges. This indicates a general need for more comprehensive guidance on subleasing. IFRS 16 is also silent on how to account for an exchange of lease contracts or assets in sublease scenarios.

88 For example, it is difficult to assess whether an entity involved in a service contract that contains an embedded lease is acting as a principal (implying a head lease and a sublease) or as an agent (where IFRS 15 would apply). This assessment requires significant judgment and can lead to diversity in practice. For instance, in supply chain management, a service provider might lease a dedicated warehouse (head lease) and charge the costs to a customer through a service contract, which may contain an embedded lease rather than a specific sublease contract.

89 There is a lack of clarity for reassessing or remeasuring the sublease when the head lease is renewed or modified. Additionally, it is not clear how a lessor should recognise finance income if the net investment in the lease from a sublease becomes a credit-impaired financial asset under IFRS 9.

90 An additional issue identified by stakeholders is a presentation mismatch in the statement of profit or loss for gains and losses arising from the head lease and the related sublease. For a financial sublease, an increase in head lease payments might be presented in the financial result of the income statement (as the financial lease receivable is accounted for under IFRS 9). However, there is no clear guidance on how to reflect this increase in the head lease liability, which is typically shown as an operating loss. Stakeholders noted that this discrepancy can lead to distortions in the profit or loss statement, particularly when the head lease and sublease conditions are identical.

91 Inter-company subleases can make the consolidation process more complex and may necessitate investments in new IT systems, increasing the costs related to IFRS 16.

(h) Administrative burden related to intra-group lease payments

92 Stakeholders noted that the application of IFRS 16 at the subsidiary level for inter-company leases can distort its financial position from a group perspective. This is particularly relevant for groups that operate with centralised real estate companies which lease or hold assets

and then sublease them within the group. Such arrangements can also complicate the consolidation process, potentially necessitating investments in new IT systems.

- 93 A suggestion has been made to consider a similar relief to the one provided under US GAAP (i.e. ASU 2023-01 Common Control Arrangements). Specifically, an intra-group lease scope exemption could be introduced under IFRS 16 to facilitate the consolidation process.

(i) Interaction between IFRS 16 and IFRS 11

- 94 Neither IFRS 11 nor IFRS 16 provide specific guidance on how to account for leases within the context of joint operations. This lack of guidance can affect the presentation of information by operators concerning leased field assets, for instance in extractive industries.

- 95 A discussion of the IFRS IC in March 2019 only addressed the liability side of the lease related to a joint operator's interest in a joint operation. It did not deal with the asset side of the lease, which led to issues in how certain activities are portrayed.

- 96 In addition, there was a concern from entities in the extractive industry that the IFRS IC agenda decision does not faithfully portray joint operating agreements. The reason is that in many cases the operator recognises 100 per cent of the lease liability even though it has the right to recover the other partners' share in the joint operation through cash calls. They are also of the view that the outcome of the agenda decision negatively affects discussions with credit rating agencies.

(j) Interaction between IFRS 16 and IAS 16 – different levels of certainty required in assessing optional periods to define the depreciation period

- 97 Stakeholders raised concerns about a discrepancy in the level of certainty required between the two Standards. Under IFRS 16, the lease term includes periods covered by extension options if the lessee is 'reasonably certain to exercise' those options. Conversely, under IAS 16.6 the useful life of an asset is determined based on the period it is 'expected to be available for use by an entity'. It is noted that IAS 16 requires a lower level of certainty than IFRS 16 in this regard.

- 98 This difference in certainty levels can lead to a potential mismatch between the lease term determined under IFRS 16 and the useful life under IAS 16 for leasehold improvements. This may create distortions in the financial statements. For example, leasehold improvements might be fully depreciated by the end of the original lease term even if the lessee subsequently exercises an extension option and continues to benefit from those improvements.

99 Despite these concerns, in November 2019 the IFRS IC concluded that the principles and requirements in both IFRS 16 and IAS 16 provide an adequate basis for entities to determine the lease term for cancellable and renewable leases and therefore the useful life of any non-removable leasehold improvements related to such leases.

100 To address this issue, stakeholders have suggested:

- (a) aligning the assessment: one suggestion is to align how the lease term is assessed with the depreciation period for leasehold improvements;
- (b) allowing non-alignment for immaterial items: another suggestion proposes allowing the possibility of not aligning the depreciation period of leasehold improvements with the lease term when the improvements are not significant and are not considered in the assessment of whether an extension option will be exercised.

(k) Interaction between IFRS 16 and IFRS 3 – Accounting for lease contracts in the context of a business combination

101 The interaction between IFRS 16 and IFRS 3 *Business Combinations* presents specific challenges, primarily related to the accounting for lease contracts in the context of an acquisition. The main issues identified are:

- (a) remeasurement methodology differences: under IFRS 3 – when a business combination occurs – the right-of-use asset and the corresponding lease liability from acquired leases must be remeasured at the present value of the remaining lease payments at the date of acquisition, as if the acquired lease was a new lease. This approach leads to different outcomes compared to the initial measurement of the lease contract;
- (b) significant costs and complexity in merger and acquisitions (M&A):
 - (i) different accounting GAAPs: when M&A involves companies that apply different accounting GAAPs, the methodology of remeasuring the lease contract at the acquisition date significantly increases the level of complexity, often requiring two sets of calculations for monitoring purposes (one for statutory accounts and one for IFRS Accounting Standards);
 - (ii) burden within IFRS 16: even if the acquired entity already applied IFRS 16 before the acquisition, remeasuring all lease contracts at the acquisition date is still a burdensome exercise. A suggestion was made whereby it would be more sensible to carry forward the values as measured by the acquiree under IFRS 16; and

- (iii) purchase price allocation (PPA) challenges: for users, especially in the context of PPA, a practical issue arises when acquired entities are non-IFRS adopters and their forecasts for PPA are based on pre-IFRS 16 figures. This makes calculating the impacts of the first-time adoption of IFRS 16 costly, complex and time-consuming, sometimes leading to the use of pre-IFRS 16 valuation models to reduce costs.

(l) Interaction between IFRS 16 and IAS 40 – Lack of clarity on the application of IAS 40.41 to the investment property held by the lessee as right-of-use asset

- 102 Stakeholders noted that there is a lack of clarity concerning the application of IAS 40 *Investment Property* to investment property that is held by a lessee as a right-of-use (RoU) asset. This means entities are not certain on how the specific accounting requirements of IAS 40.41 apply to assets they lease and then classify as investment property.
- 103 An additional concern noted is the ambiguity regarding properties that an entity rents out to earn rental income but which do not meet the definition of a 'lease' under IFRS 16; it remains unclear whether such properties should then fall within the scope of IAS 40.

(m) Interaction between IFRS 16 and IFRS 15 – Timing Mismatch in Revenue Recognition: Over Time versus Point in Time

- 104 The interaction between IFRS 16 *Leases* and IFRS 15 *Revenue from Contracts with Customers* presents a notable concern regarding the timing of revenue recognition, specifically a mismatch between 'over time' and 'point in time' approaches for lessors.
- 105 Under IFRS 15, revenue can be recognised over time if certain criteria are met, such as in contracts for the construction of an asset on the customer's site. However, for lessors IFRS 16 appears to require income recognition at a point in time for certain transactions, even when an asset takes time to construct. This specifically applies to dealer-lessors or manufacturers contracting for a specified asset with no alternative use and a right to payment for performance to date.
- 106 This issue arises for assets that require a construction period, such as those built under construction contracts on a customer's site. In situations where a dealer/manufacturer constructs or provides a specified asset, IFRS 15 might allow for over-time revenue recognition. However, if this arrangement is considered a lease under IFRS 16, the standard (specifically IFRS 16.71) seems to dictate point-in-time revenue recognition, creating inconsistency.
- 107 It is also unclear whether IFRS 16.08 applies when a seller-lessee provides a construction service to the buyer-lessor, recognising revenue over time, and then leasing the completed

asset back. The concern is that the sold asset might not be considered the same as the leased-back asset in such scenarios.

- 108 Stakeholders made a call for clarification and for additional guidance with regard to this issue.

(n) Interaction between IFRS 16 and IFRS 9 – Application of the ECLs model under IFRS 9 to lease liabilities from the lessor’s perspective

- 109 Stakeholders identified application challenges for lessors, particularly concerning the application of the Expected Credit Losses (ECLs) model under IFRS 9 to lease liabilities or finance lease receivables. The primary concern identified is a lack of clarity on how IFRS 9’s requirements should be applied from a lessor’s perspective. Stakeholders sought:

- (a) clarification regarding the cash shortfalls used to measure ECLs for lessors;
- (b) clarification on how to determine the fair value of a lease receivable at initial recognition and how this relates to the contract’s contractual rate;
- (c) guidance on how to determine the credit-adjusted effective interest rate for purchased and originated credit-impaired receivables; and
- (d) guidance on consistency of finance income recognition when the net investment in a lease becomes a credit-impaired financial asset, noting that the current method may not align with IFRS 9’s impairment requirements.

(o) Interaction between IFRS 16 and IFRS 5 (Lessee RoU Treatment)

- 110 When entities divest a business through an asset deal, they apply IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to the disposal group. This is measured at the lower of fair value less costs to sell or the carrying amount, provided that the disposal group will be recovered through sale rather than continued use (IFRS 5.6). In such transactions, a lessee may transfer an RoU asset – such as a building lease – to the buyer. However, IFRS 16 and IFRS 5 do not clarify whether this constitutes:

- (a) a lease modification, given that the lessee effectively relinquishes the RoU and lease liability; or
- (b) (b) a sale of the RoU asset as part of the disposal group.

The accounting outcome and its timing may differ significantly depending on the interpretation.

(p) Interaction between IFRS 16 and IFRS 18 Categorisation of Lease income

- 111 IFRS 18.B32(c) states that revenue from finance leases (from the lessor's perspective) should be presented within the operating category when customer financing is a main business activity. In contrast, IFRS 18 provides limited guidance on the presentation of revenue from operating leases. While IFRS 18.B46(b) cites rent from investment properties as an example of returns generated independently of other resources (IFRS 18.53(c)), operating leases are offered in various other contexts – such as by leasing companies or car manufacturers – where this condition may not be met. The absence of specific guidance on the presentation of operating lease income beyond the investment property example leads to inconsistent interpretations.

(q) Major maintenance costs

- 112 There is significant diversity in practice regarding how companies that lease transportation assets (such as aircraft) account for major maintenance costs. These differences specifically relate to maintenance costs assessed as avoidable upon the inception of the lease and to substantial components of leased assets such as engines, which must meet minimum performance conditions.
- 113 Two approaches are noted in practice: The 'Provision Approach' where issuers build up a provision until the next maintenance event, with a corresponding charge recognised in the income statement, and the 'Components Approach' where maintenance costs are recognised as part of the cost of the RoU asset, applying paragraphs 24(d) and 25 of IFRS 16. The expense is then recorded through depreciation of the RoU asset over the period leading up to the next maintenance or the end of the lease. There was a suggestion for the IASB to provide clarification in order to achieve consistent application.

(r) Interaction between IFRS 16 and IAS 29 Financial Reporting in Hyperinflationary Economies

- 114 This issue stems from the differing natures of the RoU asset (non-monetary) and the lease liability (monetary), which lead to asymmetrical adjustments upon certain trigger events. While stakeholders acknowledge the consistency of the foreign currency requirements under IAS 21 (where the lease liability is remeasured against profit or loss without a symmetrical RoU asset adjustment), this asymmetry is further increased when applied in a hyperinflationary context. Under IAS 29, the non-monetary RoU asset is subject to revaluation, exacerbating the asymmetry.
- 115 It was suggested that addressing the asymmetry created by IAS 21 / IFRS 16 should be part of a project to revise IAS 29 requirements. Stakeholders also find it relevant to clarify

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whether both the RoU asset and the lease liability qualify as ‘assets and liabilities linked by agreement to changes in prices’ in accordance with paragraph 13 of IAS 29, which could improve the relevance of financial statements restated in a hyperinflationary context.